IN THE

Supreme Court of the United States

October Term, 1963.

No.

WALTER F. O'BRIEN,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT, AS OF NO. 14,321.

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I. F. Huntzinger Co., *Appellate Printers*, Camden, N. J.

TABLE OF CONTENTS OF PETITION

	PAGE
Reports of Courts below	2
Jurisdictional Grounds	2
Questions Presented	3
1. Does "court proceedings" include the cost thereof and the fees of counsel?	2
2. Where "back pay" is recovered after litigation in three courts, is the income tax computed on the real economic benefit to the taxpayer, i. e., the amount received by him after costs and fees?	2
Statute Involved	4
Section 1303 of the Internal Revenue Code of 1954	4, 8, 9
Statement of the Case	5
Jurisdiction of Court of First Instance	6
Argument for Petitioner	7
I. The Conflict	7
II. The Law	9

TABLE OF CITATIONS

CASES:	PAGE
Cotnam v. Comm., (5th Cir.), 263 F. 2d 119	7, 9, 10
Drescher, U. S. v. 179 F. 2d 863, 865	9
Eubank, Helvering v. 311 U. S. 122	9
Horst, Helvering v. 311 U. S. 112	9
Thompson v. Comm., 205 F. 2d 73, 78	9

TABLE OF CONTENTS OF APPENDIX

Opinion of the Court of Appeals ... 12

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To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The Petition of Walter F. O'Brien respectfully represents:

REPORTS OF COURTS BELOW.

The opinion of the Court of Appeals for the Third Circuit is not as yet officially reported. It is printed in this petition (p. 12).

The opinion of the Tax Court of the United States is officially reported: *Walter F. O'Brien*, 38 T. C. 707, as cited by the Court of Appeals; but at this writing is not in bound volume. It was reviewed by the Court.

JURISDICTIONAL GROUNDS.

(i) On July 31, 1963, the United States Court of Appeals for the Third Circuit, on petition to review a decision of the Tax Court of the United States, entered a judgment affirming the decision of the Tax Court.

(ii) In view of the Per Curiam decision of the Court of Appeals affirming on the opinion of the Tax Court, no petition for rehearing was filed.

(iii) The jurisdiction of your Honorable Court is invoked under the Act of June 25, 1948, Chapter 646, 62 Stat. 928 (28 U. S. C. A. 1254).

QUESTIONS PRESENTED.

1. Does "court proceedings" include the cost thereof and the fees of counsel?

2. Where "back pay" is recovered after litigation in three courts, is the income tax computed on the real economic benefit to the taxpayer, i. e., the net recovery after deduction of counsel fees and costs?

STATUTE INVOLVED.

The statute involved is *Section 1303* of the *Internal Revenue Code of 1954*, the pertinent text of which reads:

"Sec. 1303. Income from Back Pay.

"(a) Limitation on Tax. If the amount of the back pay **received** * * * by an individual during the taxable year exceeds 15 per cent of the gross income of the individual for such year * * *."

* * * * * *

"(b) Definition of Back Pay. For purposes of this section, the term 'back pay' means * * *:

"(1) Remuneration, including wages, * * * which would have been paid before the taxable year except for the intervention of one of the following events:

* * * * *

"(B) dispute as to the liability of the employer to pay such remuneration, which is determined after the commencement of court proceedings;

* * * * * *"

STATEMENT OF THE CASE.

The Court of Appeals for the Third Circuit affirmed a decision of the Tax Court holding that attorneys' fees and court costs could not be deducted before "spreading back" a back pay award.

In the year 1957, the taxpayer was awarded (in the Court of Claims) the sum of $16,173.05 for the four years, 1952 to 1955 inclusive, as damages for breach of contract of employment. His attorney received the check, deducted $8,243.11 for costs and counsel fee, and the taxpayer left the lawyer's office with a check he received from him for $7,929.94.

The courts below "spread back" the $16,173.05 over the four years; but allow the deduction of $8,243.11 in the one year—1957, the year the taxpayer received $7,929.94. The result is a deficiency in income tax of $1,628.07 plus interest at 6%.

The taxpayer was a United States civil service employee. He was wrongfully discharged by his superiors. He retained counsel. Suit for reinstatement was entered in the District Court of the United States for the District of Columbia. The District Court found that he had been wrongfully discharged, but did not order his reinstatement because the position had been abolished. On appeal, the Court of Appeals reversed and ordered his reinstatement to a similar position (233 F. 2d 17). He then sued for "back pay" in the Court of Claims, and recovered (151 F. Supp. 282).

His attorneys earned their fee.

JURISDICTION OF COURT OF FIRST INSTANCE.

Within ninety days of the issuance of a notice of deficiency by the Commissioner of Internal Revenue under Section 6212 of the Internal Revenue Code of 1954, the taxpayer petitioned the Tax Court of the United States for a redetermination under Section 6213 of said Code.

The decision of the Tax Court was reviewed by the United States Court of Appeals for the Third Circuit under Section 7482 of said Code.

ARGUMENT FOR PETITIONER.

There are two compelling reasons why this petition for certiorari should be granted:

1. The decision is *admittedly in direct conflict* with the decision of the Court of Appeals for the Fifth Circuit in *Cotnam v. Commissioner*, 263 F. 2d 119.

2. The problem is of importance to every employee with job tenure, state, county and municipal as well as federal, and decreases the protection of civil service.

I. The Conflict.

In the case at bar, the Court of Appeals for the Third Circuit adopted the opinion of the Tax Court, which Court in explaining its refusal to follow in the instant case the decision in *Cotnam v. Commissioner*, 263 F. 2d 119 (C. A. 5), wrote as follows (38 T. C. 707):

> "We reached a similar result in *Ethel West Cotnam*, 28 T. C. 947, where the taxpayer had obtained a judgment of $120,000 in an action brought by her in an Alabama court against the estate of a decedent who had orally agreed during his lifetime to make a will bequeathing to her an amount equal to one-fifth of his estate in consideration for personal services rendered by her to him during the remainder of his life.
>
> "This court held that the $120,000 was the taxpayer's income and that her attorneys had only a lien which gave them the right to retain or receive the amount of their fees for their services."

"Our decision in *Cotnam*, in so far as it related to the method of applying Section 107* to the amount recovered by the taxpayer, was reversed in *Cotnam v. Commissioner*, 263 F. 2d 119 (C.A. 5)."

The Court of Appeals for the Fifth Circuit, in reversing the Tax Court, held that without the professional services of her lawyers the value of Mrs. Cotnam's claim was *nil*; and wrote (p. 127):

"The services of her attorneys resulted in converting that claim into a judgment and the collection of the judgment. The amount of the contingent fee was earned, and well earned, by the attorneys.

"True, in a remote rather than a proximate sense, the entire amount of the judgment had also been earned by Mrs. Cotnam, but she could never have collected anything or have enjoyed any economic benefit unless she had employed attorneys, and to do so she had to part with forty per cent of her claim long before the realization of any income from it. The only income, the only real **economic benefit**, which Mrs. Cotnam ever received was the $75,254.17 which she collected. (In our opinion, it is as illegal as it is unjust to tax her on the remaining $50,363.83 which did not pass through her hands and of which she never had control.) In a realistic sense the remaining $50,365.83 was income of the attorneys, not of Mrs. Cotnam."

In the case at bar, the only *economic benefit* to our taxpayer was $7,929.94. To argue otherwise is pure scholasticism. To say he *received* $16,173.05 is a semblance not a reality. The reality is, **that he received $7,929.94.** And the tax is imposed by *Section 1303* on the amount **received.**

* Of the Internal Revenue Code of 1939. Now Section 1303 of the 1954 Code.

When the $7,929.94 is pro-rated over 1952-53-54-55, no deficiency income tax is due.

The phrase in *Cotnam*:

> ". . . she could never have collected anything or have enjoyed any economic benefit unless she had employed attorneys . . ."

which fits the instant case as well, shows the **obvious** distinction between *valueless claims* for compensation and the cases *cited by the Tax Court: Helvering v. Horst*, 311 U. S. 112, where counsel was not needed to collect bond coupons (which the taxpayer had given away), and *Helvering v. Eubank*, 311 U. S. 122, where no lawyers were needed to collect renewal insurance commissions (which the taxpayer had assigned).

> "Taxation is an intensely practical matter, and it deals with realities not semblances; with substance and not form . . ." *Thompson v. Comm.*, 205 F. 2d 73, 78.

The income tax is imposed upon the "economic benefit" to the taxpayer: *U. S. v. Drescher* (CCA 2), 179 F. 2d 863, 865.

II. The Law.

Nor can we accept the Tax Court's statement that the Internal Revenue Code "is silent as to expenses incurred in connection with any collection of back pay."

The definition of "back pay" in *Sec. 1303 (b) (1) (B)* includes:

"(B) dispute as to the liability of the employer to pay such remuneration, *which is determined after the commencement of court proceedings;*" (Emphasis supplied.)

It is unreasonable to conclude that "court proceedings" do not include the costs thereof and the costs of representation by counsel. Congress never intended a wrongfully discharged employee should act as his own lawyer. The right of a litigant in "court proceedings" to counsel learned in the law is inherent.

Further, this is *remedial* legislation and should be liberally construed. The act says "the amount of back pay **received** . . ."

That the problem in the case at bar is one which should be resolved by your Honorable Court is apparent from the statement in the first paragraph of the *Opinion* of the Tax Court, to the effect that the Commissioner changed his position at the bar of the Tax Court from that set forth in his statutory notice of deficiency and in the pleadings before the Tax Court. To begin with: the taxpayer's 1957 return was prepared by the "taxpayers' service" desk of the local District Director. Then the statutory notice took one position; then another at the bar of the Tax Court—which it, and the Court of Appeals, adopted.

We respectfully submit that the correct answer is that given by the Fifth Circuit in *Cotnam v. Commissioner*, 263 F. 2d 119. We feel that decision is based on realities, not semblances, and on the Internal Revenue Code construed both literally and literally.

Wherefore your petitioner, Walter F. O'Brien, respectfully prays that a writ of certiorari be issued to the United

States Court of Appeals for the Third Circuit (as of No. 14,321).

Respectfully submitted,

WALTER F. O'BRIEN,
Petitioner.

By: HENRY D. O'CONNOR,
Attorney for Petitioner.

APPENDIX.

Argued June 17, 1963.

Before BIGGS, *Chief Judge*, and STALEY and FORMAN, *Circuit Judges*.

OPINION OF THE COURT.

(Filed July 31, 1963.)

PER CURIAM.

We find the decision of the Tax Court is correct in all respects and accordingly it will be affirmed on the excellent opinion of Judge Raum. 38 T. C. 707.

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No. 460

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BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 1a–9a) [1] are reported at 38 T.C. 707. The *per curiam* opinion of the court of appeals (Pet. 12) is reported at 319 F. 2d 532.

JURISDICTION

The judgment of the court of appeals was entered on July 31, 1963. (Pet. 2.) The petition for a writ of certiorari was filed on September 10, 1963. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

[1] Record references are to the appendix to the taxpayer's brief in the Court of Appeals.

707-875—63——1

QUESTIONS PRESENTED

Taxpayer sued his employer for wrongful discharge and recovered a judgment for back pay. He elected to spread back the recovery over the earlier years, in accordance with § 1303 of the Internal Revenue Code of 1954. The questions presented are:

1. Whether, in reallocating the recovery to the prior years for purposes of § 1303, the taxpayer may also reallocate to the same years any deduction for legal expenses incurred in obtaining the recovery.

2. Whether the portion of the recovery paid over by the taxpayer to his attorney pursuant to a contingent-fee contract may be excluded from the taxpayer's gross income or whether the entire recovery must be included in income with the legal fees being taken as a deduction.

STATUTE INVOLVED

Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.):

SEC. 61. GROSS INCOME DEFINED.

(a) *General Definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

* * * * *

SEC. 1303. INCOME FROM BACK PAY.

(a) *Limitation on Tax.*—If the amount of the back pay received or accrued by an individual during the taxable year exceeds 15 percent of the gross income of the individual for such year, the part of the tax attributable to the inclusion of such back pay in gross in-

come for the taxable year shall not be greater than the aggregate of the increases in the taxes which would have resulted from the inclusion of the respective portions of such back pay in gross income for the taxable years to which such portions are respectively attributable, as determined under regulations prescribed by the Secretary or his delegate.

(b) *Definition of Back Pay.*—For purposes of this section, the term "back pay" means amounts includible in gross income under this subtitle which are one of the following—

(1) Remuneration, including wages, salaries, retirement pay, and other similar compensation, which is received or accrued during the taxable year by an employee for services performed before the taxable year for his employer and which would have been paid before the taxable year except for the intervention of one of the following events:

* * * * * *

(B) dispute as to the liability of the employer to pay such remuneration, which is determined after the commencement of court proceedings;

* * * * * *

STATEMENT

In 1952, petitioner was discharged from his position as an employee of the United States. He engaged an attorney to contest the discharge on the following terms (R. 2a):

> Walter F. O'Brien hereby engages Edwin J. McDermott as his Attorney with the right to engage associates to represent him, said Walter F. O'Brien, in his action to recover damages from the United States arising out of his sepa-

> ration from the classified Civil Service of the United States as of January 14, 1952.
>
> It is agreed that for his said service Edwin J. McDermott shall receive 50% of any amount of damages or any other sums of money received by way of suit or settlement or otherwise.

In 1957, as a result of the attorney's efforts, petitioner was reinstated in his job and obtained a judgment in the Court of Claims for $16,173.05, representing back pay for the years 1952 through 1955. Upon receiving a check for that amount, petitioner endorsed the check over to his attorney and received back from him a check for $7,929.95, the difference of $8,243.10 being retained by the attorney in payment of his fee and other costs (R. 2a–3a).

In his income tax return for 1957, petitioner computed his tax under § 1303 of the Internal Revenue Code of 1954, which provides generally that the tax attributable to amounts received as back pay for prior years shall not exceed the tax that would have been due had the amounts been received in the prior years. In applying that provision, petitioner "spread back" to 1952–1955 not only the back pay attributable to those years (*i.e.*, the $16,173.05 received under the judgment) but also, as a partially offsetting deduction, the legal fees incurred in the litigation ($8,243.10). The full Tax Court, sustaining a deficiency determined by the Commissioner, held that, notwithstanding the reallocation of the back pay to the years to which it was attributable (1952–1955), the legal fees could be treated as a deduction only for the year in which paid (1957). The court of appeals affirmed *per curiam*. (R. 3a–6a, 9a; Pet. 12.)

ARGUMENT

1. Section 1303, like all of the provisions permitting a "spread-back" of various kinds of "bunched" income (§§ 1301-1307), applies only to amounts included "in gross income" and operates by constructively including the amounts "in gross income" for prior years. There is nothing in the provision authorizing related deductions to be spread back along with the gross income or—what amounts to the same thing—limiting the amounts to be reallocated to prior years to the *net* income from the recovery. The language relied upon by petitioner (§ 1303(b)(1)(B), Pet. 9–10) is patently irrelevant, being concerned only with the definition of the kind of income eligible for relief, not with the method of computing the limitation once eligibility is established. There is in any event no conflict of decisions or other reason for review of the question by this Court.

2. Alternatively, petitioner argues that only the net amount he retained out of the judgment after paying his attorney was includible in *gross* income. The argument is based on the decision of the Fifth Circuit in *Cotnam* v. *Commissioner*, 263 F. 2d 119, with which the decision in this case is said to be in conflict.

The *Cotnam* case involved a similar question under another of the "bunched income" provisions (what is now § 1301). The court there held that the portion of a judgment that was paid to the plaintiff's attorneys under a contingent-fee arrangement was not includible in the plaintiff's gross income, so that only the portion retained by the plaintiff was required to be reallocated

to the prior years. In so holding, the court construed the contingent-fee arrangement as having effected, at the time it was made, an assignment of a portion of the cause of action to the attorneys—*i.e.*, a completed transfer of ownership of a part of the claim.[2] From that premise, the court reasoned that the amounts realized on the portion of the claim owned by the attorneys was income to them and not to the plaintiff, rejecting the government's argument that under familiar assignment-of-income principles the income realized remained taxable to the plaintiff notwithstanding the assignment.

In this case, no assignment of the claim was ever made, and there is thus no occasion to reach the

[2] The controlling opinion of Judges Rives and Brown in the *Cotnam* case stated that the plaintiff, "in effect, assigned to her attorneys forty per cent of the claim"; that she had "to transfer a part" of the claim to the attorneys; that "she had to part with forty percent of her claim long before the realization of any income from it"; that the part of the proceeds paid to the attorneys "did not pass through her hands"; that she had not "obligated herself to pay the attorneys' fee" but, rather, the fee "was fully paid by the assignment of a portion of a doubtful claim"; and that she had "transferred a part interest in [the] tree to her attorneys, who then rendered the services necessary to bring forth the fruit" (263 F. 2d at 125–126). Judge Wisdom's explanation in announcing the decision (from which he himself dissented) is less clear in its import, but it seems to be based on a construction of an Alabama attorneys'-lien statute (to which there is no parallel in Pennsylvania) as working "an equitable assignment" and giving the attorney, not merely a lien, but "an equity in the cause of action" (*id.* at 125). Inasmuch as Judge Wisdom dissented on the issue while Judges Rives and Brown expressed their own views, however, Judge Wisdom's explanation of the decision has an uncertain status.

question of the effect of such an assignment. The contingent-fee contract (*supra*, pp. 3–4) constituted merely a promissory undertaking by petitioner to pay the attorney for his services 50% of any money received on the claim; it in no way purported to make a present, completed assignment of an ownership interest in the cause of action itself. Nor, for that matter, could it have done so, for any purported assignment of such a wage claim against the United States would plainly be ineffective under the Anti-Assignment Act, R.S. § 3477, 10 Stat. 170, as amended, 31 U.S.C. 203. Since petitioner thus continued to own the claim at all times and was subject only to a contractual commitment to pay his attorney a fee equal to 50% of the proceeds, there can be no question that the entire proceeds were includible in petitioner's income and the attorney's fees were entitled to be taken into account only by way of a deduction for the cost of collecting the income (§ 212(1), 1954 Code). And that is true whatever the result would have been if, as was thought to be the case in *Cotnam*, there had been a prior assignment of the claim itself.

Nor, of course, can the *Cotnam* case be said to be in conflict on the question whether the contingent-fee arrangement did operate as an assignment. While the Fifth Circuit in the *Cotnam* case did not articulate the grounds for its conclusion that a part of the claim had been assigned to the attorneys, the conclusion in its very nature could only be one about the effect of the particular arrangement under the local law (there,

Alabama law) governing assignments. The effect of the contract in this case under Pennsylvania and federal law is necessarily a different question.

CONCLUSION

The decision below is correct and, for the reasons stated, the petition for certiorari should be denied.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.
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Assistant Attorney General.
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L. W. POST,
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OCTOBER 1963.

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Petition for Rehearing

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PETITION FOR REHEARING.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petition of Walter F. O'Brien respectfully represents:

Henry Adams wrote that "One court may hang and another may acquit for the same crime, on the same day;" and in turn he quoted Blaise Pascal as saying, "three degrees of polar elevation upset all jurisprudence; * * * truths on this side of the Pyrenees! errors beyond!" but one would think in this day and age when the *entire* Tax Court concluded that it had been wrongly reversed by the Fifth Circuit in *Cotnam v. Commissioner*, 263 F. 2d 119, and the conclusion of the Tax Court was adopted *per curiam* by the Third Circuit—creating a direct conflict between the two circuits—your Honorable Court would rule which circuit was right.

Does the truth lie in Alabama, and error in Pennsylvania?

The taxpayer is one of the numerous small taxpayers—who pay the bulk of the income tax collected. Their problems should be resolved.

We respectfully ask your Honorable Court to decide this conflict between the courts of appeal—even without oral argument.

Your petitioner prays your Honorable Court to grant a rehearing of his Petition for Certiorari.

WALTER F. O'BRIEN,
Petitioner.

By: HENRY D. O'CONNOR,
Attorney for Petitioner.

CERTIFICATE OF COUNSEL.

I hereby certify that the foregoing Petition for Rehearing is presented in good faith and not for delay; also, that this Petition is restricted to the grounds above specified.

HENRY D. O'CONNOR,
Attorney for Petitioner.